THE FLORIDA LEGISLATURE

JOINT SELECT COMMITTEE ON WORKERS' COMPENSATION RATING REFORM

Location
330 Knott Building

Mailing Address
404 South Monroe Street
Tallahassee, Florida 32399-1100
(850) 487-5361

Brian Deffenbaugh, *Staff Director*

Legislature's Website: *www.leg.state.fl.us*

JAMES E. "JIM" KING, JR.
President of the Senate

JOHNNIE BYRD
Speaker of the House of Representatives

November 18, 2003

The Honorable James E. "Jim" King, Jr.
President, The Florida Senate
Suite 409, The Capitol
Tallahassee, FL 32399-1100

The Honorable Johnnie Byrd
Speaker, The Florida House of Representatives
Suite 420, The Capitol
Tallahassee, FL 32399-1100

Dear Mr. President and Mr. Speaker:

We are pleased to transmit this letter to you which contains the report and recommendations of the Joint Select Committee on Workers' Compensation Rating Reform. The Joint Select Committee was appointed pursuant to Section 40 of Chapter 2003-412, L.O.F., to study the merits of requiring each workers' compensation insurer to individually file its expense and profit portion of a rate filing, while permitting each insurer to use a loss cost filing made by a licensed rating organization. The committee was also charged with studying other rating options that would promote greater competition and would encourage insurers to write workers' compensation while protecting employers from rates that are excessive, inadequate, or unfairly discriminatory. The Joint Select Committee has taken great care to follow this charge and has sought input from the various stakeholders involved.

The Joint Select Committee on Workers' Compensation Rating Reform met three times during October and November. The committee heard testimony and received written information from the Office of Insurance Regulation, the National Council on Compensation Insurance (NCCI), and interested parties.

Findings

Florida is one of 8 states that continues to use what is known as an "administered pricing" system under which a rating bureau or statistical agency files the full workers' compensation rate, subject to the prior approval of the insurance regulatory agency which, in Florida, is the Office of Insurance Regulation. In comparison, 37 states have adopted a "loss cost" system under which a rating bureau or statistical agency files the portion of the rate that is needed to pay losses and, typically, the loss adjustment expenses associated with adjusting and defending specific claims, while each insurer must independently file a "loss cost multiplier" that reflects the insurer's general expense and profit portion of the rate. The trend among states in recent years has been to move from an administered pricing system to a loss cost system and similar variations intended to rely more heavily on competitive market forces in the setting of workers' compensation rates.

A loss cost system seeks to promote competition among insurers and maximize benefits to consumers. The National Association of Insurance Commissioners adopted the Property and Casualty Model Rating Law (1998) which provides for a loss cost system under both the prior approval version and file and use version of the model law. The potential disadvantages are the increased risk of inadequate, excessive, or unfairly discriminatory rates and increased administrative costs to the system. The Joint Select Committee found no empirical evidence from testimony and materials presented indicating that the adoption of a loss cost rating system would significantly affect rates or underwriting results. A comparison of the rates and insurer loss ratios among the states displayed no particular pattern among those states that adopted a loss cost system as compared to states with an administered pricing system.

Concern was expressed that this would not be an optimal time for Florida to change to a loss cost rating system by the Office of Insurance Regulation (OIR) and interested parties, although the director of OIR testified in favor of moving towards a more competitive rating law. This concern was primarily due to the recent enactment of major changes to the workers' compensation law in Senate Bill 50-A, the effects of which are still largely unknown, but which resulted in the filing and approval of a 14 percent rate reduction effective October 1 of this year. Carriers are also undergoing system changes to adapt to the administrative and benefit changes of the new law. Concerns about changing the rating law were also due to the alleged instability of the insurance market, as evidenced by difficulties in obtaining coverage and the growth in the number of employers forced to obtain coverage from the insurer of last resort, the Florida Workers' Compensation Joint Underwriting Association. The Joint Select Committee heard testimony, primarily anecdotal in nature, on whether the current regulatory environment creates and maintains market conditions that are conducive to competition in the workers' compensation market.

The current Florida law and the rating plans approved by OIR allow for various ways for insurers to vary or adjust premiums, including retrospective rating plans that adjust the

premium at the end of the policy period to reflect the actual loss experience of the employer; dividend plans that allow insurers to provide refunds to participating policyholders; and premium credits for large deductible policies, approved safety programs, drug-free workplaces, and other standard credits. Florida's use of such aforementioned pricing methods appears to be consistent with their use in other states.

But, certain other rating methods that vary rates among insurers and employers are used less frequently in Florida, compared to other states. Florida law permits insurers to file for approval of a rate deviation, by which the insurer proposes a uniform percentage increase or decrease to be applied to all rates charged or to rates for a particular class or classes of insurance. Deviations have been used very infrequently in Florida since 1996 when legislation (ch. 96-405, L.O.F.) revised the standards for approval and disapproval of deviation filings by the Department of Insurance (now, OIR). In addition to consideration of factors related to the actuarial soundness of the deviation filing, as are considered for rate filings generally, the law requires OIR to consider "the impact of the deviation filing on the current market conditions including the composition of the market, the stability of rates, and the level of competition in the market." The OIR is specifically required to disapprove a deviation filing if it finds the resulting premiums "would adversely affect current market conditions including the composition of the marketplace, the stability of rates, and the level of competition in the market, or would result in predatory pricing." [s. 627.211(3), F.S.]

In contrast, the rate filing standards in Florida for other lines of property and casualty insurance, as well as for deviation filings for workers' compensation in most other states, provide for disapproval of rates that are excessive, inadequate, or unfairly discriminatory. This is primarily a function of the insurer's own loss and expense factors, although some state laws (similar to a version of the NAIC model law) provide that rates cannot be considered excessive if a competitive market exists. Florida may be unique, or is at least in a distinct minority of states, in effectively using market conditions and the stability of rates as grounds for denying a rate decrease. This is more typically based on a finding that a rate is inadequate, defined in s. 627.062(2)(e), F.S., as being clearly insufficient, together with investment income, to sustain projected losses and expenses in the class of business to which they apply.

Another Florida law that allows some flexibility in rating is the "consent to rate" law (s. 627.171, F.S.) which allows an insurer to use a rate in excess of its filed rate on any specific risk (employer) with the written consent of the insured. However, an insurer may not use excess rates pursuant to this law for more than 10 percent of its commercial insurance policies written or renewed in each calendar year for any line of commercial insurance.

In recent months, an increasing number of employers have been forced to obtain coverage from the Florida Workers' Compensation Joint Underwriting Association (FWCJUA), the insurer of last resort. Premiums for coverage in the FWCJUA are typically three to four times as costly as premiums charged by insurers in the voluntary

market. The 2003 workers' compensation act imposed a premium cap in the FWCJUA of 125 percent of the standard rate for small employers with 15 or fewer employees and an experience modification factor of 1.10 or less. However, these policies are assessable, so if the premium turns out to be inadequate, policyholders will be assessed an additional amount to fund the deficit. In fact, all policies sold by the FWCJUA are subject to either assessment or increased renewal premiums to cover all claims and expenses of the FWCJUA, since the law was amended in 1993 to eliminate assessments against carriers in the voluntary market to fund FWCJUA deficits. Insurers may be willing to offer coverage to an employer in the FWCJUA at a premium above the insurer's filed rate on a consent to rate basis, but may not do so for more than 10 percent of an insurer's policies. This limitation may prevent some employers from electing to purchase coverage from an insurer at a rate in excess of the standard rate, but would allow the employer to avoid having to purchase an assessable policy.

Recommendations

After hearing the testimony and reviewing the written materials, the Joint Select Committee on Workers' Compensation Rating Reform recommends the following:

- Amend s. 627.211, F.S., to revise the standards for approval and disapproval of deviation filings for workers' compensation rates, to be similar to the law as it existed prior to 1996, to provide for disapproval of a filing if it results in premiums that are excessive, inadequate, or unfairly discriminatory. Disapproval of a deviation filing should not be based on factors beyond the loss, expense, and related financial data of the insurer making the deviation filing.

- Amend s. 627.171, F.S., to allow workers' compensation insurers to use rates in excess of their filed rates with the written consent of a policyholder, without being subject to the current maximum limitation of 10 percent of an insurer's commercial policies, for policies issued to employers who the insurer takes out of the Florida Workers' Compensation Joint Underwriting Association. Such employers should be given the option of knowingly and voluntarily accepting such coverage as an alternative to obtaining an assessable policy from the FWCJUA. The Legislature should evaluate additional potential incentives to effect the depopulation of the FWCJUA, such as premium tax credits, Workers' Compensation Administrative Trust Fund assessment abatement, or Special Disability Trust Fund assessment abatement.

- To assist the Legislature in evaluating stability in Florida's market, require the Office of Insurance Regulation to submit an annual report to the Legislature that evaluates competition in the workers' compensation insurance market. The purpose of this annual report is to determine if the state of the market ensures the availability of workers' compensation coverage and affordability of coverage at reasonable levels that are not inadequate, excessive, or unfairly discriminatory. The report would evaluate whether the current market structure, conduct, and

performance are conducive to competition, based upon analysis and economic tests. The Legislature should consider the findings of this report to determine whether any changes to the workers' compensation rating laws are warranted. The report should also document that OIR has complied with the provisions of 627.096, F.S., which requires OIR to investigate and study all workers' compensation insurers in the state and to study the data, statistics, schedules, or other information as it may deem necessary to assist in its review of workers' compensation rate filings.

- Require each workers' compensation insurer to notify the Office of Insurance Regulation in writing of a significant underwriting change that materially limits or restricts the number of policies or premiums written in this state.

The evidence presented to the committee did not demonstrate any obvious benefit or detriment as a result of changing from an administered pricing (full rate) system to a loss cost system. The director of the Office of Insurance Regulation stated that he knew of no evidence that clearly indicated that Florida would be better served under a loss cost system as compared to the current system, and that any such change should not be made until the reforms of Senate Bill 50-A have been in effect for at least 18 months and the insurance market has stabilized. This testimony and the fact that 37 states have adopted a loss cost system, which is also recommended by the NAIC as a way to promote price competition among insurers, leads us to encourage the Legislature to explore such a modification at a time when the impact of SB 50-A and the market stability that it should bring allow for a more conducive environment to revisit such a topic.

We further note that the narrow charge of the committee to make recommendations for changes to the workers' compensation rating laws does not encompass proposals that will significantly address the problems of availability and affordability of the current market. Senate Bill 50-A was intended to address these problems and did result in an immediate reduction in rates averaging 14 percent, but coverage remains difficult to obtain, particularly for small employers. One major insurer has terminated a program covering approximately 4,500 contractors in this state. Many of these non-renewals will take effect January 1, 2004, which will add to the already increasing number of employers who are forced to obtain coverage from the Florida Workers' Compensation Joint Underwriting Association. Even though small employers who meet certain criteria are subject to specified premium caps, those employers remain liable for additional premium assessments if necessary to fund plan losses. The committee recognizes that legislative solutions to these problems are likely to be advanced to address these problems, which were not the subject of our limited review.

Thank you for recognizing the importance of all these issues and for providing a forum for interested parties to participate.

Sincerely,

Senator Jeffrey H. "Jeff" Atwater
Chair

Representative Kim Berfield
Vice Chair